



DEPARTMENT OF THE ARMY
U.S. ARMY AUDIT AGENCY
Office of the Deputy Auditor General
Forces and Financial Management
3101 Park Center Drive
Alexandria, VA 22302-1596

SAAG-FFZ (36-2c)

30 August 2002

MEMORANDUM FOR Mr. William **Bragg**, Assistant Auditor General
Strategic Sourcing and Resources Management, Naval Audit Service,
1006 Beatty Place SE, Washington Navy Yard, DC 20374-5005

SUBJECT: Letter of Comments on the 2002 External Quality Control
Peer Review of the Naval Audit Service (Project Code: A-2002-FFC-
0363.000), Audit Report: A-2002-0559-FFC

We reviewed the system of quality control for the audit function of the Naval Audit Service in effect for the year ended 31 **March** 2002 and issued our opinion report (**A-2002-0560-FFC**, 30 August 2002). We reported that the system of quality control for the audit function of the Naval Audit Service was designed in accordance with the quality standards established by the President's Council on Integrity and Efficiency. We found reasonable assurance that Naval Audit Service personnel were complying with the system of quality control and were conducting audits in accordance with generally accepted auditing standards and internal policies. This letter of comments contains observations and recommendations regarding training system and quality control issues that did not warrant inclusion in our opinion report.

The purpose of our review was to report whether the Naval Audit Service's internal quality control system was designed in accordance with the quality standards established by the **President's** Council on Integrity and Efficiency and whether the Naval Audit **Service** was complying with the system for the year reviewed to provide reasonable assurance of material compliance with professional auditing standards in the conduct of its audits. We conducted our review in accordance with standards and guidelines established by the President's Council and in accordance with the Memorandum of Understanding signed in April 2002.

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of quality control. In the performance of most control procedures, departures **can** result from **misunderstanding** of instructions, mistakes in judgment,

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carelessness, or other personal factors. Projection of any evaluation of a system of quality control to future periods is subject to the risk that one or more procedures **may** become inadequate because of changes in conditions or because the degree of compliance with procedures may deteriorate.

During our review, we identified issues that we **considered** in determining our **overall** opinion. For each report reviewed, we discussed the issues with the responsible Naval Audit Service personnel and provided point papers to the responsible Assistant Auditor General. We didn't **find** that any of these issues affected the reported results of the various audits **but** they do warrant management attention. We identify our scope and methodology in Enclosure 1. We discuss our **overall** observations and **recommendations** in Enclosure 2. The Naval Audit **Service** reports that we **reviewed are** listed in Enclosure 3. Your verbatim comments are in Enclosure 4.

We express our thanks to you and your staff for your cooperation and professionalism during this review. If you **have** any questions, please contact Mr. Michael S. **Ham**, Peer Review Program Director, at Commercial (703)681-9574 or me at Commercial (703)681-9585.

4 Encls



JOYCE E. MORROW
Deputy Auditor General
Forces and Financial Management

SCOPE AND METHODOLOGY

We conducted our review during the period 8 April to 7 June 2002 in accordance with the:

- President's Council on Integrity and Efficiency's Guide for Conducting External Quality Control Operations of Offices of Inspector General, dated February 2002.

Memorandum of Understanding signed in April 2002.

We tested compliance with ~~the~~ Naval Audit Service's system of **quality** control to the extent we **considered** appropriate. We interviewed auditors, reviewed internal audit related policies and procedures, **reviewed** documentation supporting ~~required~~ auditor ~~training~~, and applied checklists based on ~~the~~ President's Council on Integrity and Efficiency guide for conducting external quality control reviews. Our tests included a ~~review~~ of 9 of 28 audit reports issued during the period 1 October 2001 to 31 **March 2002**. We **also reviewed** the one internal quality control review report issued during the period 1 October 2001 to 31 March 2002.

We visited Headquarters, Naval Audit Service located at the Washington Navy **Yard** and the Norfolk Station located at the Norfolk Naval **Base**. The audits covered work performed by Naval Audit **Service offices** at the Washington Navy **Yard**, Naval Station Norfolk, and Naval Station San **Diego**.

We provided our **observations** related to each report reviewed to the responsible Naval Audit Service Assistant Auditor General. This report summarizes our observations by issue area.

OBSERVATION A: **TRAINING** SYSTEM

The continuing professional education statistics in the Naval Audit Service's Training System were not complete. We found that the auditors were not always providing documentation for **training** received.

Government auditing standards and the **Naval** Audit **Service** Handbook require that auditors receive continuing professional education. However, the Naval Audit Management Handbook doesn't require auditors to verify that **the** training that they received is correctly recorded in the Training System.

We didn't find that this materially **affected** the Naval Audit Service's ability to comply with the continuing professional education standard contained in government auditing standards. But accurate records should be maintained to substantiate **compliance** with standards.

RECOMMENDATION AND COMMENTS

This section contains a specific recommendation and a summary of command comments.

A-1 Recommendation: Change the Naval Audit Management Handbook to require auditors, on at least an annual basis, to:

- Compare their **training records** with the data in the Naval Audit Service Training **System**.
- Notify training personnel of **any** differences **so** corrections **can** be made to the **Training** System Data Base.

Naval Audit Service Comment.: The Naval Audit **Service** agreed and stated the Management Handbook will be **revised** by 30 September 2002. Verbatim comments **are** in Enclosure 4.

OBSERVATION B: QUALITY CONTROL

Audit teams didn't always comply with **quality** control requirements in the Naval Audit Service Handbook to provide reasonable assurance that audits are conducted in accordance with internal policies and procedures and audit standards.

We found deficiencies in the following areas:

- **Quality** control procedures.
- Audit planning.
- Audit supervision.
- Evidence and **working** papers.
- Audit reporting.

While we didn't **find** that any of these deficiencies had a **material** affect on audit results. Naval Audit **Service** could improve how **they** ensure that auditors follow government audit standards and **prepare** well-supported audit reports.

Quality Control Procedures

We found no evidence that the audit teams completed **some** required **quality** control documents for two audits that produced three audit reports.

The Naval Audit Service Handbook requires **specific** procedures to be used and documents to be prepared to help maintain **quality** control. These documents include the Referencer Guide Sheet used by the Independent Referencer to ensure that the report is complete; an Editor's Checklist used by the editor to ensure **that** the report uses **the correct form** and content; and a Report **Certification** signed by management attesting to the completeness of the report. In addition, all reports should be completely cross-referenced. We found:

- Three reports **didn't** include Referencer Guide Sheets in the working papers.
- Two reports didn't have signed certifications.
- Two reports didn't have an Editor's Checklists in the working **papers**.
- One report didn't have the Executive Summary and Introduction cross-referenced.

Checklists and certifications allow supervisors to ensure that all audit standards have been met on the audit. Cross-referencing ensures that the facts presented in a report are accurate and supported by working papers.

Audit Planning

We found no evidence that the audit teams completely developed, used, or updated audit programs for four audits that produced **five** reports.

An audit program provides a consistent approach to preparing working papers when several auditors **are** involved and ensures the audit is conducted in the most **efficient** and effective manner. The Naval Audit Service Handbook requires auditors to write a unique audit program for each audit. Government auditing standards **require** that if auditors make changes to their plans, ~~they~~ should update the program.

We found that for:

- Two audits (with 3 reports), the auditors **didn't update** the audit program to **reflect** changes from the original audit plan.
- One audit, the audit team **didn't** prepare an audit program to ensure **all** aspects of planning were considered. The Project Manager stated that the **staff** had been involved with similar efforts and didn't need an audit program for this work.
- One audit, the audit team didn't develop and use an audit program because the auditors viewed the effort as research and not as an audit. However, the **working** papers clearly documented the transition from a research effort to an audit.

Complete and up-to-date audit programs are used to ensure that all program objectives are accomplished.

Audit Supervision

The Naval Audit Service Handbook requires that supervisors review and initial, as a minimum, all working papers referenced in the audit report. Whether all **working** papers should be reviewed depends on the skill level of the auditors, the **complexity** of the audit, and the day-to-day supervision. The Handbook also requires the Project Manager to prepare a **Working** Paper Review Sheet (or **similar** automated form) to provide comments, **auditor's** actions on the comments, and supervisor's acceptance of the actions.

For six audits that produced seven audit reports, we found deficiencies in documentation of some working paper reviews as follows:

- Five audits, with six reports, referenced some working papers that **weren't reviewed** by a supervisor.
- Three audits didn't have review sheets or electronic substitutes that indicated if auditors took corrective action or if the action was satisfactory.

Supervisors should follow Naval Audit Service policies and review **all** working papers referenced in an audit report, document their reviews, and follow up to make sure that the auditors **take** any **corrective** actions needed. Supervisory reviews of working papers are important to ensure well-documented audit results. This is a repeat observation from the **1999** peer review and was also identified as a deficiency in the internal **quality** control review report that we included in our scope.

Evidence and Working Papers

The Naval Audit Service Handbook requires that facts and figures in an audit report be cross-referenced to the supporting **working** papers and that summary working papers be prepared.

We selectively reviewed 136 cross-references in **9** published reports. We observed that cross-referencing wasn't adequate for **16** facts included in 5 audit reports.

- Seven facts were referenced to the wrong working papers. We determined that the facts were included in other working papers.
- Two facts were from documents that weren't included in the working papers. The Project Managers later produced the documents.

- Two facts referenced a prior audit's audit program and not specific **sources**. The Project Manager later produced a document supporting one of the facts.
- One fact was referenced to a list of **individuals** that included double counting one person. This caused a **scope** number in the report to be presented as 44 instead of 43.
- One fact was not cross-referenced.
- One fact was a number that was incorrectly rounded.
- One **fact** referenced **two** sets of data. However, there **was** no **crosswalk** to tie the two **sets** of data together.
- One fact was as an opinion of a Project Manager and should have been stated as such.

In addition, we found no evidence that **summary working papers** were prepared for two of four areas in one audit.

Although none of these **errors** had a material impact on the audit reports, **generally** accepted auditing standards and Naval Audit Service policies require that **all** facts in audit reports be supported by documentary evidence.

Audit Reporting

We identified **seven** instances (in five audit reports) **where** required , information was omitted from reports. The Naval Audit **Service** Handbook requires that the report include the **definition** of the audited universe, a conclusion section, and the cause of a condition in the finding. The audit report should **also** include a response to any disagreements with command positions on the issues.

We found:

- Two reports without the universe of amounts that were audited.
- Two reports without conclusion sections.
- One report without a cause for the **reported** condition.
- One report without a scope in the finding.

- One report that didn't rebut disagreements with the recommendation.

These sections are required to help ensure compliance with reporting standards for performance audits. Reporting that does not rebut disagreements with command is a repeat **observation** from the 1999 peer review.

RECOMMENDATIONS AND COMMENTS

This section contains specific recommendations and a summary of Naval Audit Service comments for each recommendation.

B-1 Recommendation: Emphasize to supervisors the need to follow **all** requirements in the **Naval** Audit Service Handbook regarding completing quality control forms and checklists, maintaining complete audit programs, documenting supervision, **cross-**referencing to **working** paper evidence, and following audit reporting formats.

Naval Audit Service Comments: The Naval Audit Service agreed and stated that its August **2002** Senior Leadership conference agenda included discussion of Peer Review results with emphasis on supervision and quality control review issues. **They** also stated they have invited the General Accounting **Office** to discuss Generally Accepted Government Auditing Standards at the Naval Audit Service Professional Development Institute in October **2002**. Verbatim comments **are** in Enclosure 4.

B-2 Recommendation: Require internal quality control reviews to emphasize completing quality control forms and checklists, maintaining complete audit programs, documenting **supervision**, cross-referencing reports to working paper evidence, and following audit reporting formats.

Naval Audit Service Comments: The Naval Audit Service agreed and stated that their quality control review guide requires review of quality control **forms/checklists**, audit programs, supervision, cross-referencing, and reporting. Therefore, these areas are reviewed during their single audit quality control reviews. The

Naval Audit Service also stated that additional improvements have been made to their Referencer Guide Sheet based on the peer review findings. In addition, they stated their fiscal year 2003 quality control review plan would include crosscutting reviews of topics where they have indicators of potential systemic issues. These indicators will come from senior leadership input, results of this peer review and their recently completed internal quality control reviews. The recommended action will be completed by 30 October 2002. Verbatim comments are in Enclosure 4.

AUDIT REPORTS REVIEWED		
Report Number	Report Date	Report Title
N2002-0003	26 October 2001	Military Construction Project Development for Fiscal Year 2003 Program
N2002-0004	25 October 2001	Fiscal year 2000 Reporting and Visibility of Air Launched Decoys
N2002-0014	4 December 2001	Effectiveness of System and Equipment Warranties at Selected Department of the Navy Activities
N2002-0015	13 December 2001	Contracting and Related Functions at Naval Security Group Activity, Sugar Grove, West Virginia
N2002-0022	8 January 2002	Department of the Navy's Fleet Modernization Program
N2002-0023	10 January 2002	Management of the Purchase Card Program at Public Works Center, San Diego, California
N2002-0028	13 February 2002	Fiscal Years 2001 and 2000 Department of the Navy General Fund Financial Statements
N2002-0029	13 February 2002	Fiscal Years 2001 and 2000 Department of the Navy Working Capital Fund Financial Statements
N2002-0031	25 February 2002	Assault Craft Unit Operational Readiness

INTERNAL QUALITY CONTROL REPORT REVIEWED		
Report Number	Report Date	Report Title
N2002-0002	5 October 2001	Quality Control Review of Audit 2001-0007: Marine Corps Total Ownership Cost Reduction Plans

Enclosure 3

VERBATIM COMMAND COMMENTS



DEPARTMENT OF THE NAVY
NAVAL AUDIT SERVICE
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WASHINGTON NAVY YARD, DC 20374-5005

7547
13 Aug 2002

MEMORANDUM FOR PROGRAM DIRECTOR, U.S. ARMY CORPS OF
ENGINEERS AUDITS, ARMY AUDIT AGENCY

Subj: **2002 EXTERNAL QUALITY CONTROL PEER REVIEW OF NAVAL
AUDIT SERVICE (ASSIGNMENT NUMBER: A-2002-FFC-0363.000)**

Encl: (1) Army Audit Agency recommendations and Naval Audit Service Comments

1. We reviewed the Opinion Report and Letter of Comments and concur with the opinion and suggested actions. We plan to revise our training documentation requirements, reemphasize Generally Accepted Government Auditing Standards to all auditors in our October 2002 Professional Development Symposium, and design crosscutting quality control reviews for areas of significant systemic issues. Enclosure (1) contains a response to each of the three recommendations.

2. If you have any questions, please contact Mr. Douglas Robinson, Director, Policy and Oversight, at (202) 433-5126.

William E. Bragg

WILLIAM E. BRAGG
Assistant Auditor General
Strategic Sourcing and Resources Management

Enclosure 4

Army Audit Agency Recommendations and Naval Audit Service Comments

A-1 **Recommendation:** Change the Naval Audit Management Handbook to require, on at least an annual basis, auditors to:

- Compare their training records with the data in the Naval Audit Service Training System
- Notify training personnel of any differences so corrections can be made to the Training System Data Base.

Naval Audit Service Comments: Concur. The Naval Audit Service Management Handbook will be revised to require auditors to annually compare training records with data in the Naval Audit Service Training System and notify training personnel of any differences so corrections can be made. The Management Handbook will be revised by 30 September 2002.

B-1 **Recommendation:** Emphasize to supervisors the need to follow all requirements in the Naval Audit Manual regarding completing quality control forms and checklists, maintaining complete audit programs, documenting supervision, cross-referencing to working paper evidence, and audit reporting formats.

Naval Audit Service Comments: Concur. The August 2002 Naval Audit Service Senior Leadership conference agenda includes discussion of Peer Review results with emphasis on supervision and quality control review issues. A plan of action for areas of emphasis to be communicated to supervisors will be formulated based on the consensus of the leadership. Additionally, we have invited GAO to discuss Generally Accepted Government Auditing Standards for all our audit personnel at our October 2002 Professional Development Institute. Therefore, the recommended action will be complete by 30 October 2002.

B-2 **Recommendation:** Require quality control reviews to emphasize completing of quality control forms and checklists, maintaining complete audit programs, documenting supervision, cross-referencing reports to working paper evidence, and audit reporting formats.

Naval Audit Service Comments: Concur. Our quality control review guide requires review of quality control forms/checklists, audit programs, supervision, cross-referencing, and reporting. Therefore, these areas are reviewed during our single audit quality control reviews. We will reiterate this requirement.

Based on the results of these reviews, Strategic Sourcing and Resources Management (SSR) updates the referencing and/or editing checklists to increase the likelihood that errors will be identified and corrected prior to report

End: (1)
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publication. Numerous changes have recently been made to our checklists based on recent internal quality control review results. These changes were not in effect for the audits included in this Peer Review. Additional improvements have been made to our Referencing Guidesheet based on the Peer Review findings. Based on recently published quality control reviews and the Peer Review, SSR is presenting the issue of documenting supervision to the Senior Leadership for a consensus on a plan of action as noted above. We will schedule a future crosscutting review of the status of implementation of supervision improvement actions.

Our Fiscal Year 2003 Quality Control Review plan will include crosscutting reviews of topics where we have indicators of potential systemic issues based on both Senior Leadership input and results of this Peer Review and the results of our recently completed internal quality control reviews of single audits. While some of the examples presented in the Letter of Comments are isolated instances of noncompliance, SSR will use both referencing and quality control reviews to look for and minimize/eliminate these types of errors. Other topics such as audit program preparation/updating and proper cross-referencing may be included in the Fiscal Year 2003 Quality Control Review plan.

Recommended action will be complete by 30 October 2002.

Encl: (1)
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